

Internal Revenue Service

memorandum

CC:TL-N-2655-88

Brl:RTBailey

date: FEB 25 1988

to: District Counsel, Austin CC:AUS

from: Director, Tax Litigation Division CC:TL

subject: [REDACTED]

This is in response to your request for technical advice dated January 19, 1988, and will confirm our authorization by telephone on February 18, 1988, to settle the above-captioned case as to attorney fees in the amount of \$ [REDACTED] pursuant to I.R.C. § 7430.

ISSUE

Whether the position of the United States was substantially justified within the meaning of section 7430. 7430-0000.

CONCLUSION

Although we do not believe that the Tax Court would be authorized to award petitioners attorneys' fees under section 7430, based on the facts of this case, we believe that payment of the fee as part of an agreed settlement is warranted.

FACTS

Petitioners were issued a statutory notice of deficiency in this case on [REDACTED], based on the issuance of an erroneous Form 1099 for \$ [REDACTED] by a bank in [REDACTED], Texas. Prior to the issuance of the statutory notice of deficiency, the taxpayer's accountant on [REDACTED], provided verification to the Service that the taxpayers had reported all their income on their tax return designating \$ [REDACTED] "income" rather than "dividends."

Petitioners timely filed a petition in the Tax Court on [REDACTED], and on [REDACTED], the Dallas District Counsel filed an answer denying that the notice of deficiency was issued in

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error. On [REDACTED], the Appeals Office proposed conceding the case by a stipulated decision. However, the stipulated decision conceding the deficiency was never filed with the court, consequently the case was transferred to Austin District Counsel on [REDACTED].

LEGAL ANALYSIS

Because this case was initiated after December 31, 1985, it is governed by section 7430, as amended by section 1551 of the Tax Reform Act of 1986, P.L. 99-154, 100 stat. 2085, 2752. Section 7430 authorizes the award of reasonable litigation costs to a taxpayer who prevails in a civil action under the Code with the government in any federal court. The statute lists the following three requirements which the taxpayer must satisfy before the taxpayer is a prevailing party:

1. Taxpayer must substantially prevail in the litigation (section 7430(c)(2)(A)(ii));
2. Taxpayer must have exhausted administrative remedies available to him (section 7430(b)(2)); and
3. Taxpayer must establish that respondent's position is not substantially justified (section 7430(c)(2)(A)(i)).

1. Substantially Prevail

In the instant case, the petitioners has substantially prevailed. A stipulated decision has been prepared which concedes there is no deficiency due from petitioners.

2. Exhaustion of Administrative Remedies

A taxpayer is deemed to have exhausted his administrative remedies if he did not receive a 30-day letter and he discussed the case with the Appeals Division after the petition is filed. Treas. Reg. § 301.7430-1(f)(2). In the instant case, the petitioners did not receive a 30-day letter and apparently petitioners did discuss the case with the Appeals Office after the petition was filed. Also, their accountant responded to Service audit inquiries with full substantiation and explanation of the matter. There is no indication that throughout this procedure petitioners failed to take advantage of any administrative remedies.

3. Substantial Justification

Section 7430 allows the court, in this case the Tax Court, to award fees and costs to successful petitioners in civil actions under the Code. In order to be entitled to fees in post 1986 cases, the petitioner must show that the government's position was not substantially justified. The Tax Court has held in Sher v. Commissioner, 89 T.C. 79 (1987), Rutana v. Commissioner, 88 T.C. 1329 (1987), and Rogers v. Commissioner

T.C. Memo 1987-374, that substantially justified is the same as reasonable in part relying on pre-1985 Equal Access to Justice Act (EAJA) cases.

While we favor this definition of substantially justified, we also believe it is subject to being modified since the Tax Court did not focus on the 1985 amendments to the EAJA. When EAJA was amended in 1985, the definition of substantial justification was clarified. The legislative history of the amendments indicates that substantial justification means more than mere reasonableness on the part of the government. H.R. Rep. No. 120 at 9, 1985 U.S. Code Cong. and Ad. News at 138.

In Gavette v. Office of Personnel Management, 758 F.2d 1568 (Fed. Cir. 1986), the court held that substantial justification requires that the government show that it is clearly reasonable in asserting its position. Id. at 1579. The court relied on the aforementioned 1985 amendments to EAJA and the legislative history in so concluding. Under Gavette, in order to show that respondent's position was not substantially justified, the petitioner must prove that respondent has persisted in pressing a tenuous factual or legal position, albeit one not wholly without foundation. Id.

In addition, in Sher, supra, the Tax Court held that it has no authority to grant an award of fees and costs except as related to a proceeding over which the court has jurisdiction -- the successful petition of a notice of deficiency. Activity before the involvement of the District Counsel attorney, pre-petition collection activity, or the unreasonableness of a notice of deficiency, are not matters over which the Tax Court may act. The Tax Court is a court of limited jurisdiction, and is not empowered in disputes arising out of allegedly improper administrative activity. Moreover, the granting of attorneys' fees and costs against the sovereign by statute is a waiver of sovereign immunity, and such waivers must be strictly construed in favor of the sovereign. Ruckelshaus v. Sierra Club, 463 U.S. 680 (1983); Ewing and Thomas, P.A. v. Heye, 803 F.2d 613 (11th Cir. 1986).

In the most recent cases under the post-1986 Tax Reform Act provision for attorneys' fees, the Tax Court has followed a conservative approach. Only the actions of the government after the filing of the petition are considered relevant to the determination of whether or not the government is substantially justified in its position. Sher, supra; Shifman v. Commissioner, T.C. Memo 1987-347; Rouffy v. Commissioner, T.C. Memo 1987-5. In Shifman the court found that no fees were allowable, no matter how the notice of deficiency had been generated administratively as long as the district counsel attorney acted promptly to dismiss the action and concede the deficiency after the petition was filed. The Rouffy case considered the same question, dealing only with the issue of

whether the time required for the case to be conceded after the filing of the petition was reasonable. In Rouffy the petition was filed in July, 1985. District Counsel researched the case and determined that it should be conceded within the ensuing five months. This delay was considered to be reasonable, under the pre-1986 standards.

However, the court has found on some occasions that if concession was unreasonably delayed the delay itself will give rise to an award of fees under section 7430. Stiena v. Commissioner, 89 T.C. No. 55 (October 8, 1987). In the instant case, there was a five month delay before the Appeals Office offered to concede the underlying substantive tax issue. The egregiousness of the administrative error could incline the court to make an award based on such a delay. Therefore, there are some litigation hazards present. Although the Tax Court precedents are strongly in our favor, a case such as this one could expand the reach of section 7430 considerably were the court to rule against us, possibly to the extent of holding that any case based on similar facts in which we did not promptly concede results in an unjustifiable delay, which supports an award under section 7430.

For these reasons, as communicated to you by phone on February 18, 1988, we concur with your recommendation that the attorneys' fees issue be conceded in this case and authorize you to prepare a decision document reflecting that petitioners be awarded \$ [REDACTED] as reasonable litigation costs.

MARLENE GROSS

By:

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